

REPORT OF EXAMINATION
OF THE
ULICO STANDARD OF AMERICA
CASUALTY COMPANY
AS OF
DECEMBER 31, 2005

Filed May 23, 2007

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Los Angeles, California
February 9, 2007

Honorable Steve Poizner
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

ULICO STANDARD OF AMERICA CASUALTY COMPANY

(hereinafter also referred to as the Company) at its administrative office located at 1625 Eye Street, Washington, D.C. 20006. The Company's statutory home office is located at 14726 Ramona Avenue, Suite 202, Chino, California 91710.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2002. This examination covers the period from January 1, 2003 through December 31, 2005. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2005, as deemed necessary under the circumstances.

The examination was conducted concurrently with the examination of the Company's affiliate, Ulico Casualty Company, a Delaware domiciled company.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: corporate

records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; business in force by states; accounts and records; and sales and advertising.

COMPANY HISTORY

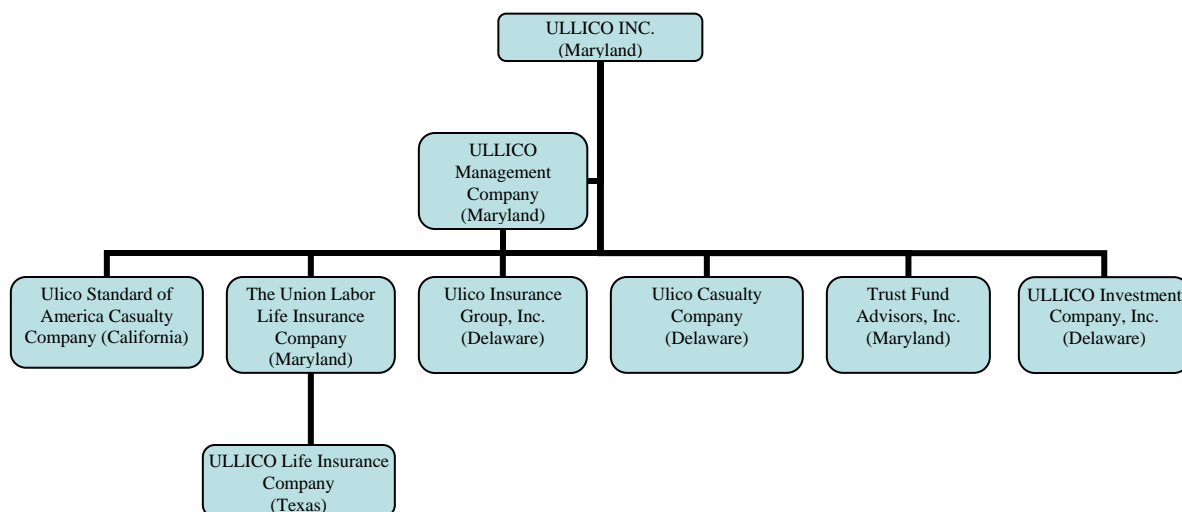
The Company was a wholly-owned subsidiary of Ulico Holding Company, Inc. (UHC) through December 31, 1996. UHC was a Delaware domiciled property and casualty holding company that owned, in addition to the Company, 100% of Ulico Casualty Company (UCC). UHC was, in turn, owned by ULLICO Inc. (ULLICO), a Maryland domiciled insurance holding company organized in 1987.

In 1997, UHC was dissolved and the ownership of the Company was transferred to ULLICO. On December 31, 1997, the Company was contributed to UCC. On June 30, 2000, the Company was sold back to ULLICO. The Company's wholly-owned subsidiary, USACC Property, was dissolved in January 2003.

Under the terms of a Guaranty Agreement (Guaranty) entered into on June 30, 2000 by ULLICO in favor of and for the benefit of the Company, ULLICO agreed to guaranty the maintenance of capital and surplus in the Company at a level sufficient to meet the Risk-Based Capital (RBC) company action level determined in accordance with the procedures adopted by the National Association of Insurance Commissioners. ULLICO agreed to calculate the RBC company action level each calendar quarter and make additions to the Company's paid-in capital as necessary to fund the minimum required under RBC calculations and by the California Department of Insurance. During the period under examination, the Company has received a total of \$15.1 million in capital contributions from ULLICO.

MANAGEMENT AND CONTROL

The following abridged organizational chart, which is limited to the Company's parent along with certain other affiliated companies, depicts the Company's relationship within the holding company system:



All ownership is 100%.

Management of the Company is vested in a five-member board of directors elected annually. A listing of the members of the board and principal officers serving on December 31, 2005 follows:

Directors

Name and Residence

Edward Grebow
New York, New York

David A. Christhilf
South Riding, Virginia

Principal Business Affiliation

President, ULLICO Inc.

Assistant Vice President and Actuary, Ulico Casualty Company and Ulico Standard of America Casualty Company

Name and ResidencePrincipal Business Affiliation

Daniel Aronowitz
 Falls Church, Virginia
 Terence M. O'Sullivan
 Vienna, Virginia

President, Ulico Casualty Company and Ulico
 Standard of America Casualty Company
 President, Laborers International Union of
 North America and Chief Executive
 Officer, Ulico Casualty Company, Ulico
 Standard of America Casualty Company
 and ULLICO Inc.

Mark E. Singleton
 Woodbine, Maryland

Treasurer, Chief Financial Officer and Senior
 Vice President, Ulico Casualty Company
 and Ulico Standard of America Casualty
 Company

Principal OfficersNameTitle

Daniel Aronowitz
 Mark E. Singleton

President
 Treasurer, Senior Vice President and
 Chief Financial Officer

Terence M. O'Sullivan
 Teresa E. Valentine

Chairman and Chief Executive Officer
 Secretary

James M. Paul
 William W. Blanton, Jr.
 Adam M. Fried

Senior Vice President, Human Resources
 Vice President and Chief Actuary
 Assistant Vice President and
 Assistant Treasurer

David A. Christhlf

Assistant Vice President and Actuary

Management Agreements

Consolidated Services Agreement: Under the terms of a Consolidated Service Agreement (Agreement), effective May 1, 1999, the Company's parent and an affiliate (ULLICO Inc. and Ulico Casualty Company) provide the Company with certain administrative and special services relating to its insurance operations. Services provided include accounting, tax and auditing, legal, actuarial, employee benefit plans, personnel administration, sales, electronic data processing, communications, and investment services. The Agreement specifies that, to the extent possible, reimbursement for services provided are to be on an actual cost basis and include a fixed annual fee for corporate

oversight. In 2003, 2004 and 2005, the Company paid \$953,717, \$422,542 and \$653,165, respectively, under the terms of the Agreement.

A review of this Agreement disclosed that it was not submitted to the California Department of Insurance (CDI) for review and approval pursuant to California Insurance Code (CIC) Section 1215.5(b)(4). It is recommended that the Company submit this Agreement to the CDI for approval. The Company is also required to disclose this Agreement and any related amendments in its Holding Company (Form B) filings each year pursuant to CIC Section 1215.4(b)(3)(E).

Consolidated Income Tax Allocation Agreement: Effective December 31, 1987 and amended on May 1, 2000, the Company, along with other subsidiaries of ULLICO Inc., is a party to a Consolidated Income Tax Allocation Agreement (Tax Agreement). The Tax Agreement provides that the consolidated tax liability of the affiliates will be allocated to each member based on the percentage of the income tax liability of each member, computed on a separate return basis. In 2003, 2004 and 2005, the Company was reimbursed \$4,537,945, \$0 and \$1,514,673, respectively, under the terms of the agreement.

A review of this Tax Agreement disclosed that since it was entered into prior to changes in the CIC sections relating to holding company transactions (effective January 1, 1997), it is not subject to CDI approval. However, the amendment that was effective May 1, 2000 is subject to the current requirements of the code and would require approval. Based on a review of the Tax Agreement and the amendment, it was noted that the Company did not submit the amendment to the CDI for review and approval. As a result of these findings, it is recommended that the Company submit the amendment (along with the current Tax Agreement) to the CDI for approval pursuant to CIC Section 1215.5(b)(4). The Company is also required to disclose this Tax Agreement and all related amendments in its Holding Company (Form B) filings each year pursuant to CIC Section 1215.4(b)(3)(H).

TERRITORY AND PLAN OF OPERATION

The Company is licensed only in California. Since the Company's inception in 1993, it has not written any direct business. Currently, the Company only exists to runoff surety, workers'

compensation and commercial multiperil business assumed from its affiliates under the terms of a loss portfolio transfer agreement. The Company has no immediate or long-term plans to write business and it will continue to runoff existing business.

The surety business is expected to be substantially run off within the next year. The workers' compensation and commercial multi-peril coverages will continue for several more years.

LOSS EXPERIENCE

The following is a summary of the Company's loss experience, as reported by the Company, for the last five years:

| Description | Year/Amounts (000 Omitted) | | | | |
|---|-----------------------------------|--------------------|--------------------|--------------------|--------------------|
| | <u>2001</u> | <u>2002</u> | <u>2003</u> | <u>2004</u> | <u>2005</u> |
| Net Premiums Earned | \$ 4,462 | \$ (65) | \$ (107) | \$ 122 | \$ 0 |
| Net Losses and Loss Expenses Incurred | 13,792 | 11,658 | 17,076 | 896 | 1,500 |
| Net Other Underwriting Expense Incurred | 1,939 | 872 | 1,051 | 408 | 630 |
| Net Loss from Underwriting | \$(11,269) | \$(12,595) | \$(18,234) | \$(1,182) | \$(2,130) |
| Net Investment Income (Loss) | 729 | (1,185) | 275 | 2,685 | 1,604 |
| Net Income (Loss) | \$(13,103) | \$ (6,956) | \$(13,513) | \$ 1,031 | \$ 1,026 |

As noted above, the Company sustained substantial underwriting and net losses from 2001 through 2003. In total, the Company reported net losses of \$31.5 million from 2001 through 2005. The reported net losses were primarily due to the runoff of the Company's workers' compensation business. Through September 2006, the Company reported a net income of \$1.1 million. For the last two and three-quarter years (2004 through September 30, 2006) the Company reported net income of \$3.2 million. The Company maintained its surplus position during the period covered by

this examination primarily through capital contributions totaling \$15.1 million made by its parent in accordance with the terms of the previously mentioned Guaranty Agreement.

REINSURANCE

Assumed

Effective July 1, 2000, the Company was no longer part of the Intercompany Pooling Agreement (Pooling Agreement) with Ulico Casualty Company (UCC) and Ulico Indemnity Company (UIC). Upon termination of participation in the Pooling Agreement, the Company paid \$4.9 million in cash to UCC and transferred all liabilities previously assumed.

Simultaneous with the termination of the pooling agreement, the Company entered into a Loss Portfolio Transfer Agreement (LPT Agreement) with UCC and UIC. Under the terms of the LPT Agreement, UCC and UIC ceded 100% of its loss reserves on its surety, commercial multi-peril, and certain discontinued workers' compensation lines of business to the Company. In addition, UCC and UIC transferred to the Company unearned premium reserves and loss and loss adjustment expense reserves of \$2.6 million and \$47.7 million, respectively. Assets transferred under the terms of the LPT Agreement were maintained with UCC in accordance with the funds withheld provisions of the agreement.

On February 23, 2001, the California Department of Insurance approved the Company's termination of participation in the Pooling Agreement and the 100% assumption of UCC's and UIC's losses and unearned premium reserves under the terms of the LPT Agreement.

In 2003, the funds withheld under the terms of the LPT Agreement were depleted and UCC began paying claims on behalf of the Company with its own assets. As of December 31, 2005, the Company recorded a \$1.5 million liability for reinsurance payable on paid losses and loss adjustment expenses due UCC for claims it paid in the fourth quarter of 2005 on behalf of the Company.

In April 2003, under the terms of an Escrow Agreement, the Company established an escrow account in order to allow Ulico Casualty Company (UCC) credit for the reinsurance ceded to the Company under the terms of the previously mentioned LPT Agreement. Although the LPT Agreement does not mention the escrow account, the Company indicated that it specifically relates to the LPT Contract and that the funds held in the escrow account are solely to be used as collateral (not for payment of claims unless the Company was to default in its payment obligation under the LPT contract) for the reinsurance receivable due from the Company. As of the examination date, \$17.5 million of the Company's assets are held in the escrow account.

As a result of the above findings, it is recommended that the Company amend the LPT and Escrow Agreements so that they each make reference to these agreements and to state that the funds held in the escrow account are solely to be used as collateral for the reinsurance receivable due from the Company under the terms of the LPT Agreement. The amendment to the LPT Agreement should also be submitted to the California Department of Insurance for approval pursuant to California Insurance Code Section 1215.4(b)(3)(F).

The Company reported assumed loss and loss adjustment expense reserves from UCC in the amount of \$30.5 million as of year-end 2005.

Ceded

Although the Company is a named participant on various quota share and excess of loss reinsurance agreements with its parent and affiliates, it does not cede business under these treaties.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2005

Underwriting and Investment Exhibit for the Year Ended December 31, 2005

Reconciliation of Surplus as Regards Policyholders
from December 31, 2002 through December 31, 2005

Statement of Financial Condition
as of December 31, 2005

| <u>Assets</u> | <u>Ledger and Nonledger Assets</u> | <u>Assets Not Admitted</u> | <u>Net Admitted Assets</u> | <u>Notes</u> |
|---|--|--------------------------------|--------------------------------|--------------|
| Bonds | \$ 34,131,896 | \$ | \$ 34,131,896 | (1) |
| Cash and short-term investments | 3,861,941 | | 3,861,941 | (1) |
| Investment income due and accrued | 406,453 | | 406,453 | |
| Federal income tax recoverable | 1,514,673 | | 1,514,673 | |
| Net deferred tax asset | 3,400,860 | 3,400,860 | | |
| Receivable from parent, subsidiaries and affiliates | 26,399 | | 26,399 | |
| Aggregate write-ins for other than invested assets | <u>2,500,000</u> | | <u>2,500,000</u> | (2) |
| Total assets | <u>\$ 45,842,222</u> | <u>\$ 3,400,860</u> | <u>\$ 42,441,362</u> | |
| <u>Liabilities, Surplus and Other Funds</u> | | | | |
| Losses | | | \$ 23,856,038 | (3) |
| Reinsurance payable on paid losses and loss adjustment expenses | | | 1,456,587 | |
| Loss adjustment expenses | | | 6,654,829 | (3) |
| Other expenses | | | 2,680 | |
| Taxes, licenses and fees | | | 200,000 | |
| Payable to parent, subsidiaries and affiliates | | | <u>194,459</u> | |
| Total liabilities | | | 32,364,593 | |
| Common capital stock | | \$ 3,000,000 | | |
| Gross paid-in and contributed surplus | | 52,828,580 | | |
| Unassigned funds (surplus) | | <u>(45,751,811)</u> | | |
| Surplus as regards policyholders | | | <u>10,076,769</u> | |
| Total liabilities, surplus and other funds | | | <u>\$ 42,441,362</u> | |

Underwriting and Investment Exhibit
for the Year Ended December 31, 2005

Statement of Income

Underwriting Income

| | | |
|--------------------------------------|----------------|------------------|
| Premiums earned | | \$ 0 |
| Deductions: | | |
| Losses incurred | \$ 603,707 | |
| Loss expenses incurred | 896,294 | |
| Other underwriting expenses incurred | <u>630,130</u> | |
| Total underwriting deductions | | <u>2,130,131</u> |
| Net underwriting loss | | (2,130,131) |

Investment Income

| | | |
|------------------------------|---------------------|-----------|
| Net investment income earned | <u>\$ 1,603,583</u> | |
| Net investment gain | | 1,603,583 |

Other Income

| | | |
|---|-----------|---------------------|
| Net gain from agents' or premium balances charged off | \$ 37,625 | |
| Aggregate write-ins for miscellaneous income | <u>40</u> | |
| Total other income | | <u>37,665</u> |
| Net loss before federal income taxes | | (488,883) |
| Federal income taxes incurred | | <u>(1,514,673)</u> |
| Net income | | <u>\$ 1,025,790</u> |

Capital and Surplus Account

| | | |
|---|------------------|----------------------|
| Surplus as regards policyholders, December 31, 2004 | | \$ 5,550,979 |
| Net income | \$ 1,025,790 | |
| Change in net deferred income tax | (1,376,806) | |
| Change in nonadmitted assets | 1,376,806 | |
| Surplus adjustments: Paid-in | <u>3,500,000</u> | |
| Change in surplus as regards policyholders | | <u>4,525,790</u> |
| Surplus as regards policyholders, December 31, 2005 | | <u>\$ 10,076,769</u> |

Reconciliation of Surplus as Regards Policyholders
from December 31, 2002 through December 31, 2005

| | | | |
|---|----------------------------|----------------------------|----------------------|
| Surplus as regards policyholders, December 31, 2002, per Examination | | | \$ (4,781,478) |
| | <u>Gain in Surplus</u> | <u>Loss in Surplus</u> | |
| Net loss | \$ | \$ 1,255,851 | |
| Net unrealized capital losses | | 664,989 | |
| Change in net deferred income tax | | 260,955 | |
| Change in nonadmitted assets | 260,956 | | |
| Surplus adjustments: Paid-in | 15,091,843 | | |
| Aggregate write-ins for gains in surplus | <u>1,687,243</u> | | |
| Totals | <u>\$ 17,040,042</u> | <u>\$ 2,181,795</u> | |
| Net increase in surplus as regards policyholders | | | <u>14,858,247</u> |
| Surplus as regards policyholders, December 31, 2005, per Examination | | | <u>\$ 10,076,769</u> |

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Bonds

(1) Cash and Short-term Investments

As previously discussed in this report under the caption “Reinsurance”, \$17.5 million of the Company’s invested assets as of year-end 2005 are pledged as collateral to its affiliate, Ulico Casualty Company (UCC), for the payment of losses assumed under the terms of a Loss Portfolio Transfer (LPT) Agreement. These assets are maintained in an escrow account under the terms of an Escrow Agreement between the Company, UCC and Mellon Trust of Delaware in order to allow UCC credit for reinsurance ceded to the Company.

Also, as noted previously in this report, the LPT Agreement does not mention the escrow account, but the Company indicated that it specifically relates to the LPT Agreement. At the examination request, the Company provided an affidavit signed by the two officers of the Company and UCC stating that the funds held in the account are solely to be used as collateral for the reinsurance receivable due from the Company under the terms of the LPT Agreement. Based on the above, recommendations were made (see “Reinsurance” caption in this report) to require the Company to amend the LPT and escrow agreements so that they each make reference to these agreements and to state that the funds held in the escrow account are solely to be used as collateral for the reinsurance receivable due from the Company.

Based on the above findings and recommendations and in accordance with Statements of Statutory Principles (SSAP) No. 4, the \$17.5 million pledged assets are allowed as admitted assets since these assets are solely for the purpose of meeting policyholder obligations and the Company has recorded a corresponding liability relating to these obligations.

In addition to the \$17.5 million pledged, \$20.8 million of the Company’s assets are held with the California Department of Insurance (CDI) for the protection of California workers’ compensation policyholders in accordance with California Insurance Code Section 11690.

(2) Aggregate Write-ins for Other than Invested Assets

The above captioned asset balance of \$2.5 million represents a capital contribution receivable due from the Company's parent, ULLICO Inc., as of year-end 2005. The CDI approved the recording of this receivable as of year-end on May 23, 2006. The approval was based on documentation supporting the cash contribution, which was made on February 24, 2006.

(3) Losses and Loss Adjustment Expenses

Based on an analysis of the Company's loss and loss adjustment expense reserves by a Casualty Actuary engaged by the Delaware Department of Insurance, and a review of their work by a Casualty Actuary from the California Department of Insurance, the Company's reserves for losses and loss adjustment expenses as of year-end 2005 were determined to be reasonably stated.

It was noted that the Company has exposure to asbestos claims arising from the issuance of commercial multiple peril policies to electrical contractors, who are being sued as peripheral defendants in asbestos lawsuits. As of year-end 2005, the Company recorded reserves for these claims in the amount of \$2.3 million.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Management and Control – Management Agreements (Page 5): It is recommended that the Company submit its Consolidated Services Agreement (Agreement) to the California Department of Insurance (CDI) for review and approval pursuant California Insurance Code (CIC) Section 1215.5(b)4. The Company is also required to disclose this Agreement and any related amendments in its Holding Company (Form B) filings each year pursuant to CIC Section 1215.4(b)(3)(E).

Management and Control – Management Agreements (Page 5): It is recommended that the Company submit all amendments to its Consolidated Income Tax Allocation Agreement (Tax

Agreement) entered into on or after January 1, 1997 to the CDI for review and approval pursuant to CIC Section 1215.5(b)4. The Company is also required to disclose this Tax Agreement and all related amendments in its Holding Company (Form B) filings each year pursuant to CIC Section 1215.4(b)(3)(H).

Reinsurance – Assumed: (Page 8): It is recommended that the Company amend the LPT and Escrow Agreements so that they each make reference to these agreements and to state that the funds held in the escrow account are solely to be used as collateral for the reinsurance receivable due from the Company under the terms of the LPT Agreement. The amendment to the LPT Agreement should also be submitted to the California Department of Insurance for approval pursuant to California Insurance Code Section 1215.4(b)(3)(F).

Previous Report of Examination

Corporate Records (Page 7): It was recommended that the Company implement procedures in its board meetings to ensure compliance with CIC Section 735. The Company has complied with this recommendation.

Reinsurance - Assumed (Page 9): It was recommended that the Company establish adequate reserves to meet its obligations under the terms of the LPT Agreement. The Company has complied with this recommendation.

Common Stocks (Page 15): It was recommended that the Company review its investment policies for compliance with CIC Section 1198 limitations. The Company has complied with this recommendation.

ACKNOWLEDGEMENT

The courtesy and cooperation extended by the officers and employees of the Company's parent during the course of this examination are hereby acknowledged.

Respectfully submitted,

/S/

Hilary C. Solomon, CFE
Examiner-In-Charge
Senior Insurance Examiner
Department of Insurance
State of California